

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT :

**THE HONOURABLE MR. JUSTICE C.N.RAMACHANDRAN NAIR
&
THE HONOURABLE MR. JUSTICE K.M.JOSEPH**

MONDAY, THE 25TH SEPTEMBER 2006 / 3RD ASWINA 1928

ITA.No. 108 of 2001()

ITA.508COCH/1993 of I.T.A.TRIBUNAL,COCHIN BENCH DT.31.1.2001.

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APPELLANT:

**THE COMMISSIONER OF INCOME TAX,
COCHIN.**

**BY ADV. SRI.P.K.R.MENON(SR.),SC FOR IT
SRI.GEORGE K. GEORGE, SC FOR IT**

RESPONDENT:

**M.S.UNITED CATALYSTS (INDIA) LTD.,
BINANIPURAM**

**BY ADV. SRI.P.BALACHANDRAN
SMT.PREETHA S.NAIR**

**THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD
ON 25/09/2006, THE COURT ON THE SAME DAY DELIVERED THE
FOLLOWING:**

C.N.RAMACHANDRAN NAIR & K.M.JOSEPH, JJ.

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I.T.A. No.108 of 2001
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Dated this the 25th day of September, 2006.

JUDGMENT

Ramachandran Nair, J.

The question raised is whether the Tribunal is justified in confirming first appellate order allowing the provision for liquidated damages claimed by the respondent-assessee. The respondent-assessee is engaged in manufacture and marketing of catalysts. The case of the assessee is that in many cases supplies are beyond the time agreed upon and therefore, buyers are entitled to claim liquidated damages in terms of purchase order. Even though the Assessing Officer does not discuss the reason for part disallowance or the basis on which balance claim is allowed by him, the assessee furnished details before the Commissioner of Income Tax (Appeals) as well as before the Tribunal and both the authorities allowed the claim in full. During the assessment year 1990-91 the assessee made a provision towards liquidated damages for Rs.16,23,672/-. However, the Assessing Officer out of the said amount disallowed an estimated amount of kRs.4 lakhs on the ground that evidence was not available to allow the full claim.

2. On going through the Tribunal's order we find that they have referred to atleast one contract and found that liquidated damages payable by the assessee was at the rate of half percent per week subject to a maximum of 5% in the case of failure on the part of the assessee to deliver the material in time. The Tribunal

further found that during the accounting year relevant for this year the petitioner received Rs.2,02,444/- from out of provision made for earlier years and the same was adjusted against provision under Section 41(1) of the Income Tax Act and only the balance is claimed in this year. Therefore, obviously the assessee is following a trade practice of making a provision for the accounting year after setting off the actuals received from out of earlier year's provisions in this year. Strangely, the assessee has not furnished the details before the Assessing Officer at the time of assessment and the Assessing Officer also did not bother to call for the purchase orders to find out whether there is a rational basis for making the provision. Liquidated damages are always precisely computable as rates of penalty will be covered by contracts or purchase orders. If the assessee is sure about the entitlement of the claim of the purchaser, then we see no reason why the amount should not have been shown in the bill or as a credit note so that only net amount gets credited in the accounts. On the other hand, if assessee is waiting for the buyer's claim and if there is any scope for negotiation or bargaining, then the assessee will be justified in making a provision which also should be based on the terms of the purchase order or contract. In other words, if the liquidated damages are provided in the contract or purchase order, then the assessee is entitled to make the claim in terms of the same. The assessee should have produced the details before the officer and it was open to the officer to examine whether provision is made based on the contract and if so, to allow the same. In other words, there is

no scope for estimated disallowance from provisions made to provide for liability in terms of the contract. From the order of the Tribunal it is clear that assessee has a clear basis for creating the provision and is following a system of accounting by adjusting subsequent receipts against provisions. If this is a regular practice of the assessee, we see no reason for disallowance of any estimated amount by the officer. In view of the specific finding by the Tribunal as above, we find no ground to interfere with the Tribunal's order. The Income Tax Appeal is therefore dismissed. However, it would be open to the officer to examine the rationality of the claim based on contracts as stated above for later years.

C.N.RAMACHANDRAN NAIR
Judge

K.M.JOSEPH
Judge

pms

C.N.RAMACHANDRAN NAIR &
K.M.JOSEH, JJ.

T.R.C. No. of 200

JUDGMENT

Dated